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Intelligence Report

Office of Asian Pacific and Latin American Analysis

1 February 1999

Peru-Ecuador: Prospects for a Peace Dividend

Summary

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The Presidents of Peru and Ecuador are playing up potential benefits of the peace deal they signed last October in an effort to persuade their publics to support it.

- Both are touting promises of increased bilateral trade, international development aid, and plans to reprogram defense spending for social programs. [redacted]
- ***Each President needs to be able to point to some tangible benefit from the border accord for political reasons:*** Peru's Fujimori is contemplating another run at the presidency, and Ecuador's Mahuad is struggling to push through unpopular economic reforms. [redacted]

While both countries will see some immediate payoffs, many benefits will become apparent only in the longer term.

- [redacted]
- ***Trade expansion may occur only gradually given the similarity of the two countries' main exports.***
- ***Both Presidents appear committed to cutting defense spending, but are likely to move slowly to avoid alienating their militaries.*** [redacted]

Despite what will probably be a slow pace, development plans for the border region provide opportunities for US companies.

- The two countries plan to solicit bids for ambitious road, irrigation, and other infrastructure projects.
- ***US firms could provide expertise and technology to develop potentially lucrative industries near the coastal border.*** [redacted]

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Mixed Reactions to Border Accord

Negative public reaction in Ecuador has been largely eclipsed by the debate over taxation and other economic reforms.

Many public commentators have lamented the loss of Ecuador's historical territorial claims, but most agree that the accord is the best that Quito could have achieved.

The Peruvian Congress—dominated by President Fujimori's supporters—overwhelmingly approved the deal, but the peace accord has at best lukewarm public support in Lima and some sectors have rejected it virulently:

- The opposition American Revolutionary Alliance Party expelled its congressional representatives who voted to ratify it, and residents of Loreto Department, which abuts the border area most affected by the agreement, have staged violent protests against the terms of the accord.

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Both Sides Trying To Sell the Border Agreement

After more than three years of tortuous negotiations to resolve their longstanding border dispute, Peru and Ecuador signed a comprehensive peace accord in October 1998. Although the Congress in each country has signed off on the deal, which required compromises on both sides,¹ some popular opposition to the agreement remains—particularly in Peru. In an effort to sell the peace accord to their respective constituencies, Ecuadorian President Mahuad and Peruvian President Fujimori are each touting the “peace dividend” that could result from the deal.

Mahuad has emphasized the prospects of large-scale foreign aid to help persuade a resigned citizenry to support the border settlement with Peru:

- Quito’s expectations received an early boost the week the accord was signed when the Latin American Reserve Fund announced a \$411 million loan—its largest ever—to help Ecuador finance its balance-of-payments deficit and support its monetary policy, according to press reports. Although granted to address macroeconomic needs, the timely assistance from the Reserve Fund frees the Mahuad government to allocate other resources to development of the border area.
- In early November, the Inter-American Development Bank (IDB) lent Ecuador \$48 million on soft terms for reconstruction along the El Niño-battered coast; Mahuad may cast projects funded by this money as part of the “peace dividend.”

Mahuad announced in January that the military budget would be cut, including money for any new arms purchases.²

Quito appears to have put on hold

This report is intended for policymakers at the State Department and National Security Council in advance of the planned visit to Washington by the Presidents of Ecuador and Peru.

¹ The agreement awarded virtually all of the disputed territory to Peru but entitles Ecuador to two export-processing zones on Amazon River tributaries; free, perpetual and unrestricted navigation of the Amazon River and its tributaries; and a symbolic claim to a key military outpost in the previously contested territory. Less controversial were pacts on border integration and mutual confidence-building measures.

² Mahuad said Quito would honor previously signed contracts, including Ecuador’s deal to purchase two Kfir C-10s from Israel and have Israeli technicians upgrade seven of Ecuador’s existing C-2 Kfir aircraft to C-10s.

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Peru-Ecuador: Leaders Wasting No Time on Demarcation

Presidents Fujimori and Mahuad, who are under pressure from their constituencies to produce the promised peace dividend, are anxious to complete border demarcation and finalize the peace process in order to focus on pressing economic problems and other domestic concerns. Both presidents are actively lobbying foreign governments and international financial institutions for aid and other visible signs of support, which they say will help to attract foreign investment.

Mahuad, who has focused almost exclusively on border issues since taking office in August, has turned his attention to Ecuador's dire economic situation.

The Presidents have appointed highly qualified career diplomats to lead the border demarcation commissions in an effort to expedite and facilitate the process.

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plans to acquire any advanced weapons systems. Ecuador could realize substantial savings by trimming military expenditures; [REDACTED]

- Defense Minister Gallardo has said publicly that the military will cut personnel by reducing conscription, while at the same time increasing its role in the fight against narcotics trafficking and crime, as well as doing more to support economic development.

[REDACTED]

Peru's Fujimori, meanwhile, has been heralding the potential for payoffs resulting from increased trade between the countries and is seeking to palliate scattered opposition to the agreement through tangible policies. At his behest, Fujimori's supporters have rushed through Congress an Amazon development law, which is intended to promote investment in select provinces (see map) by means of tax breaks and other incentives, according to press reports. The President has also publicly promised to redirect much of the money previously spent on defense to building new schools, roads, and other infrastructure:

- Fujimori announced shortly after signing the border deal that Peru would suspend purchases of big-ticket military hardware, [REDACTED]
- He claims publicly that cuts in the defense budget in coming years will save "tens of millions" of dollars. [REDACTED]

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Ambitious Border Integration Agreement

The Agreement on Border Integration, Development and Neighborly Relations—one element of the comprehensive peace deal—commits the former disputants to cooperate in a number of areas, and calls for them to:

- Integrate and improve their electricity, transportation, telecommunications, and other infrastructure in the border region.
- Collaborate on public health and sanitation programs, anti-crime and counternarcotics efforts, environmental protection and sustainable development, improving living standards for indigenous communities, and natural disaster prevention and response.
- Open three new border crossings to supplement the current two and simplify regulations for the transit of people and vehicles between the two countries.
- Reduce tariffs gradually so that by 2001 most products are duty free, except for those products slated for liberalization within the Andean Community by 2005.

Under the rubric of the accord, Quito and Lima also agreed to a blueprint for several bilateral commissions to implement these plans, including the Binational Fund for Peace and Development. The Fund is to solicit grants from foreign governments and international organizations and distribute funds for regional development, including:

- Credits for micro-, small-, and medium-sized enterprises.
- Need and feasibility studies for development projects.
- Social and service infrastructure development, including for projects initiated by border communities.

The two countries have a tentative ten-year budget for these projects totaling \$3 billion, some 62 percent of which is projected to come from grants from foreign governments, multilateral institutions, and other donors.

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Both Presidents have touted the peace deal's plans for integration of the border regions as springboards to increased development (see box). These plans, however, are predicated on significant assistance from international institutions and foreign governments. So far, Lima and Quito have received pledges for only a fraction of the \$3 billion required to implement their plans:

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- The Peruvian Foreign Minister announced in December that Japan has pledged \$5 million for border development.

- Mahuad and Fujimori will visit Washington on 4-5 February to hold what is being billed as a "financial summit" with officials of the IDB and the World Bank to mark those institution's contributions to the bilateral "peace fund"; Brazilian and other guarantor officials may also attend.

- Continuing public assurances by Peruvian officials that the White House will hold a ceremony in which the US President blesses the agreement and pledges funding have raised public expectations of such an event,

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Anticipating Increased Trade

Both countries are publicly hailing opportunities for expanding bilateral trade—totaling about \$350 million in 1997, according to CIA estimates—under the terms of the peace accord. The Agreement on Border Integration, Development and Neighborly Relations contains several provisions designed to expand trade, including a scheduled reduction of tariffs on most goods over the next five years, and the governments and private businessmen are already seeking to take advantage of the new atmosphere of friendliness:


- [Redacted]
- A delegation of Peruvian businessmen that visited Ecuador in mid-November came home with some \$24 million worth of deals, according to press reports.
- [Redacted]

Countries Unlikely To Meet Ambitious Goals


Although both countries will probably see some payoff from the border agreement in the form of foreign aid, increased trade and investment, and decreases in defense spending, the short-term benefits are likely to fall short of the promises that Fujimori and Mahuad have made. The two countries may have trouble raising money in the short term for their planned ten-year, \$3 billion joint “peace fund”—largely financed by foreign donors:

- [Redacted]
- Peru and Ecuador intend to hold a donors’ conference later this year, but may have trouble securing further pledges of financial aid so close on the heels of Peru’s successful conference last November which solicited donations for alternative development programs in coca growing regions.

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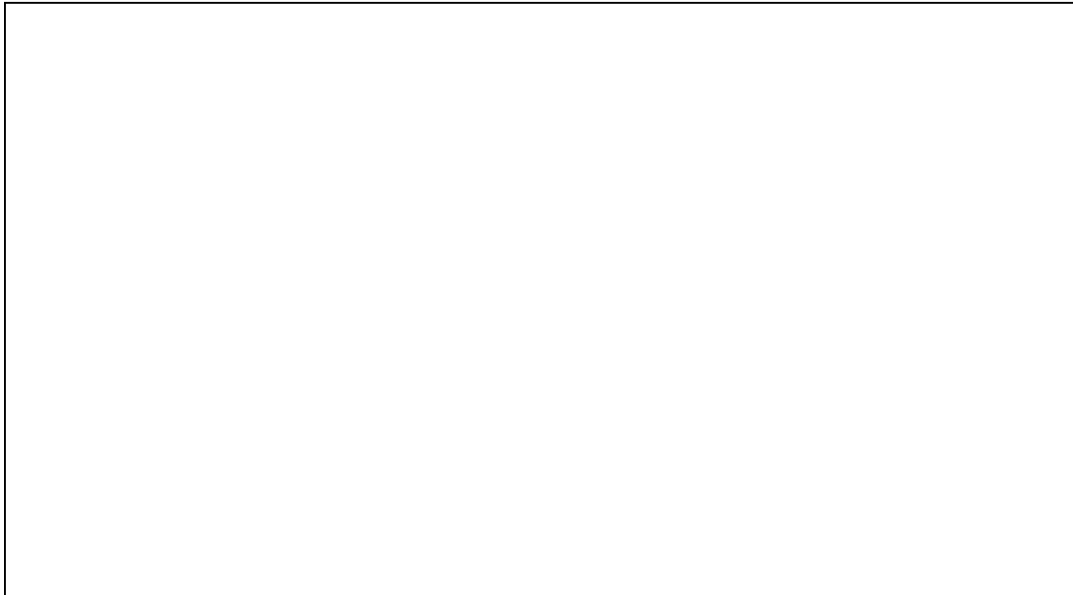
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The border integration agreement's mandates for decreased tariffs and other steps toward eliminating trade barriers will help to stimulate some augmented trade immediately. Planned improvements in border-area infrastructure—including upgrades to highways—will help to increase cross-border commerce, although such expansion may be apparent only over the longer term:

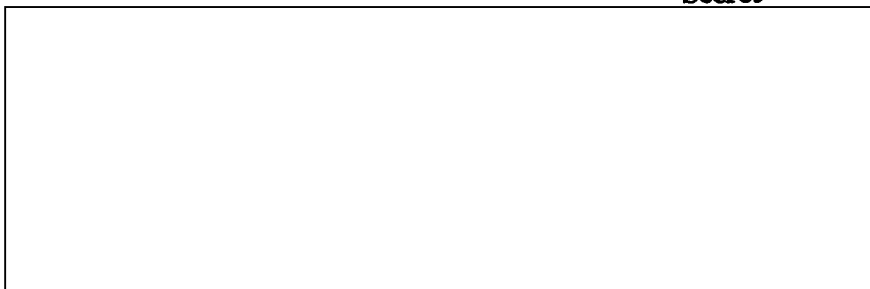
- The similarity of many of the two countries' traditional exports—including raw materials such as oil and agricultural goods—limits the prospect for immediate expansion.
- Both countries will probably continue to rely heavily on the United States and Europe to fulfill their demands for consumer and other manufactured goods, which neither country has the capacity to produce at present. 

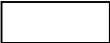
The benefits to Ecuador of its access to the Amazon River and its tributaries and the export-processing zones near those rivers may also take some time to manifest themselves. The source of financing for the construction of the centers is unclear. Moreover, in our view, the road infrastructure in the Amazon area will have to be upgraded before it can handle the substantial amounts of commercial vehicular traffic that will be necessary for Ecuador to use its export-processing centers effectively.






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Although the border accord's benefits will probably fall short of the Presidents' promises, opposition to the deal in either country is unlikely to derail implementation of the agreement, including border demarcation. Ecuador's economic troubles are the more pressing issue in that country. Public unhappiness in Peru is unlikely to translate into political opposition, especially given the compliant nature of Congress, in which Fujimori holds a majority. Moreover, implementation of the border accord's terms is unlikely to affect the daily life of citizens in either country, providing little concrete incentive for active opposition. 

Nonetheless, both Presidents want to be able to point to tangible benefits from the border deal for political reasons:

- Fujimori's popularity remains near its nadir even as he continues to weigh the possibility of running for a controversial third consecutive term next year.
- Mahuad's plans to confront Ecuador's deepening economic troubles with austerity measures and increased taxes have prompted strident public protests, 

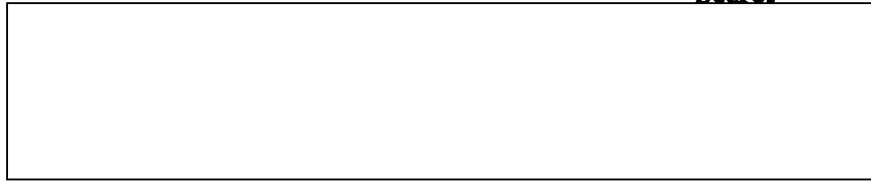
Opportunities for the United States

The plans for increasing investment and trade in the border regions and for improving border infrastructure provide abundant opportunities for US investment once Peru and Ecuador secure adequate financing:

- The border integration agreement's plans for construction of new roads and border crossings and improvements to existing ones—projects worth an estimated \$400 million—call for a competitive bidding process in which US firms could compete.



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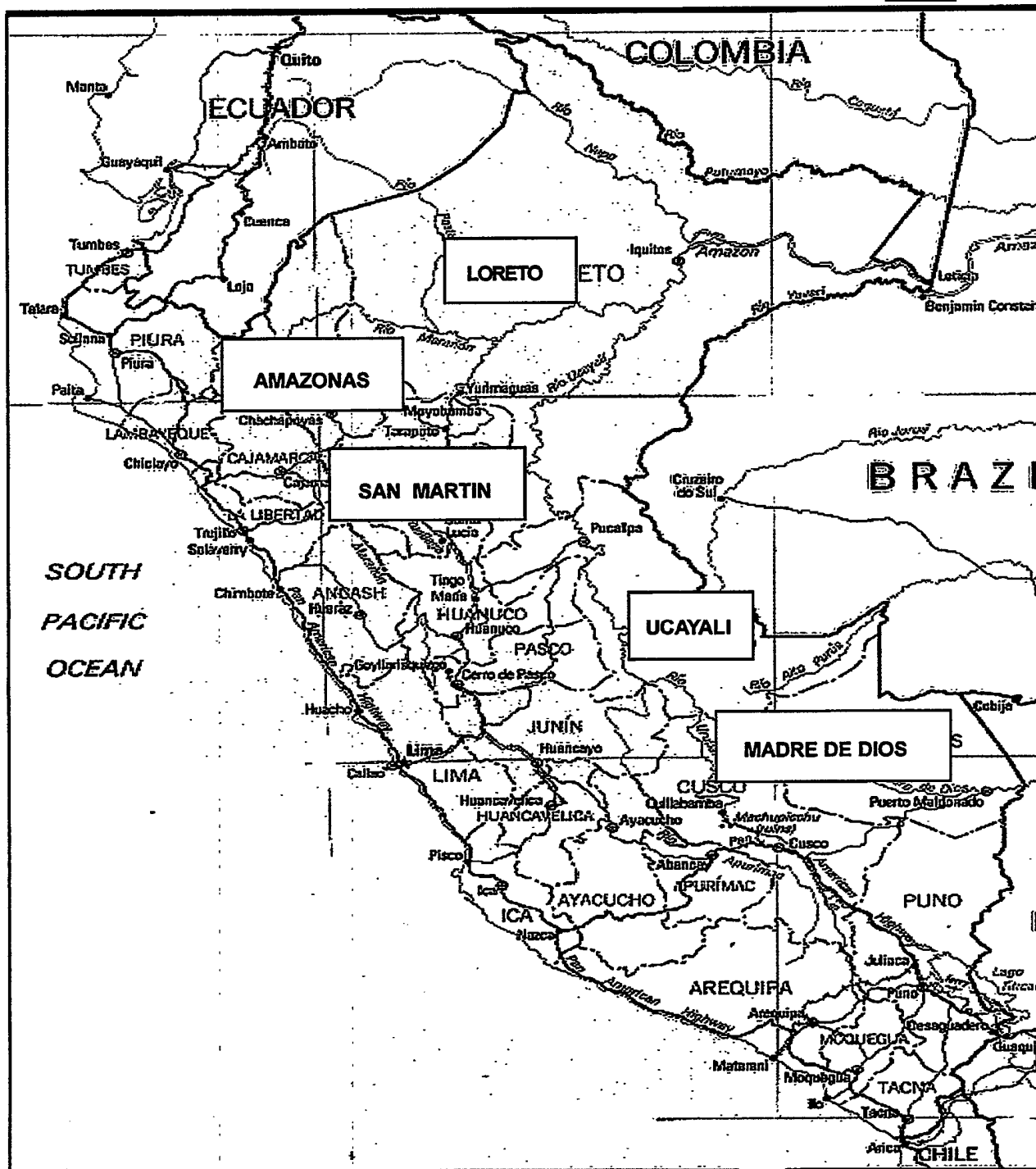
- The fishing sector in the coastal border area also suffers from antiquated technology and a lack of processing or packaging plants.



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PERU: Departments Included in Amazonian Investment Law



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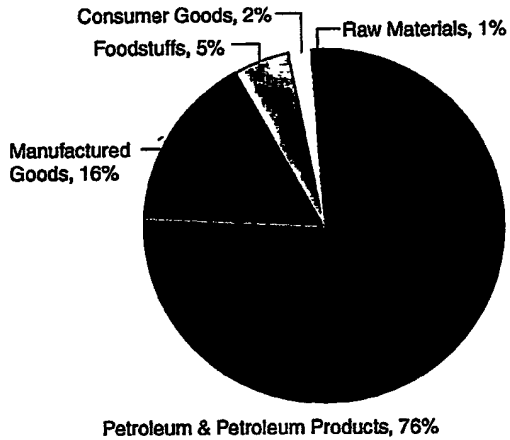
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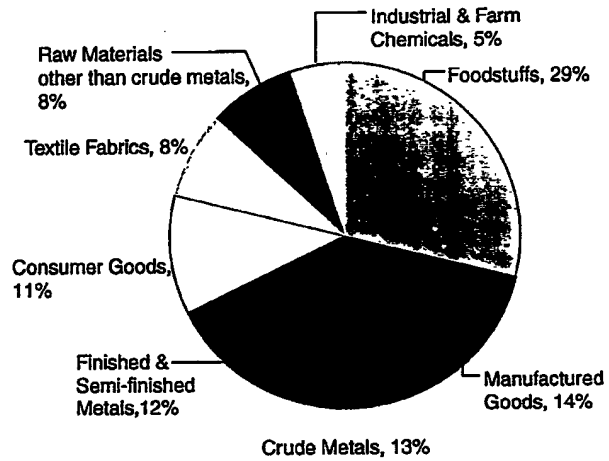


PERU-ECUADOR: Prospects for Increased Trade

Composition of Ecuador's Exports to Peru, 1997



Composition of Peru's Exports to Ecuador, 1997



Trade statistics show that trade between Peru and Ecuador currently accounts for little of the two countries' total commerce. The similarities in their main export commodities—largely raw materials and foodstuffs—suggest that any expansion in bilateral trade would probably come from nontraditional exports and manufactures.

Data is from most recent year available.
Source: United Nations Trade Statistics

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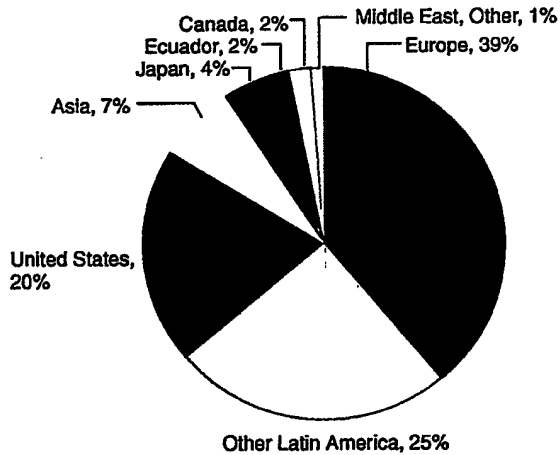
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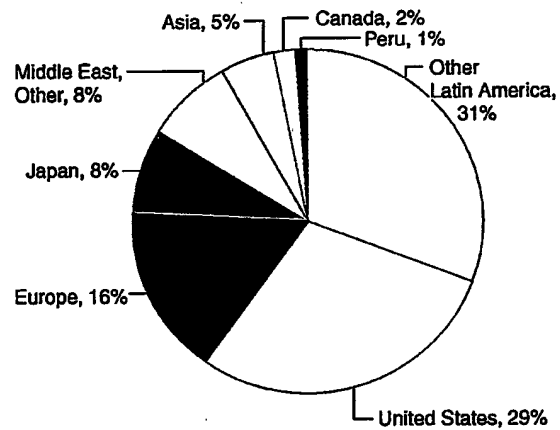


PERU-ECUADOR: Prospects for Increased Trade

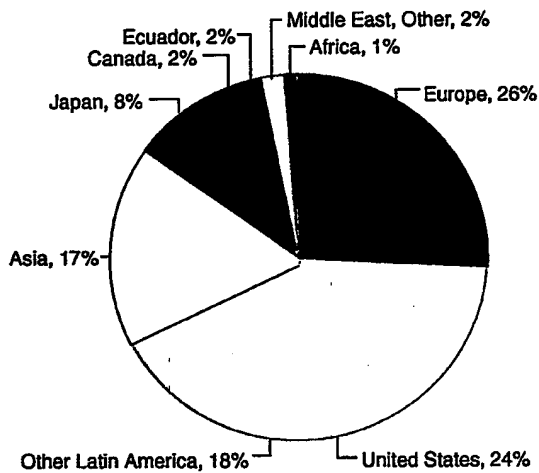
Peru's Total Imports by Partner, 1997



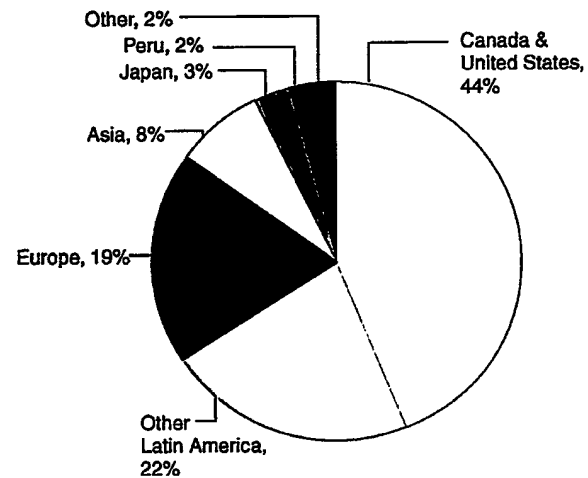
Ecuador's Total Imports by Partner, 1995



Peru's Total Exports by Partner, 1997



Ecuador's Total Exports by Partner, 1995



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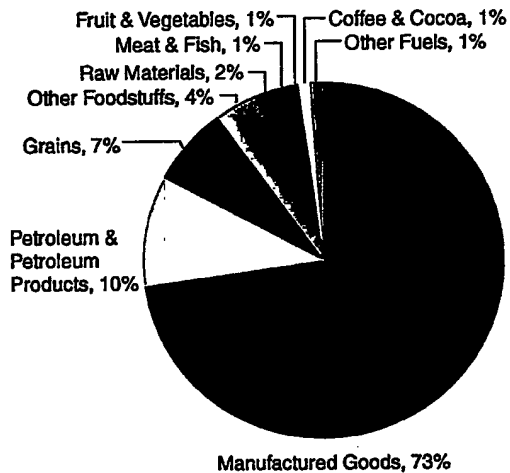
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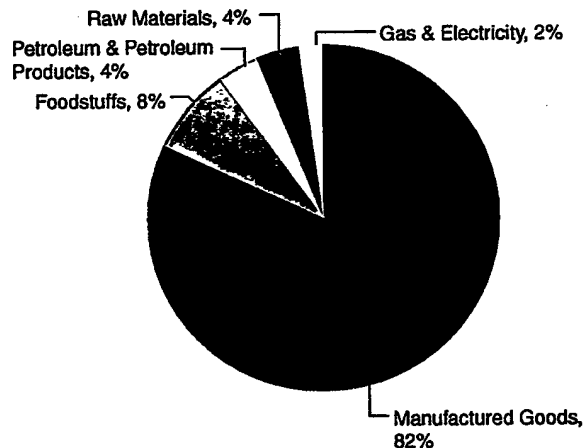


PERU-ECUADOR: Prospects for Increased Trade

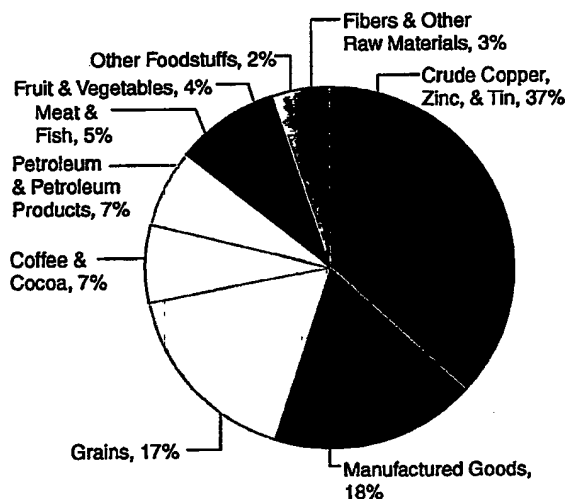
Peru's Total Imports by Commodity, 1997



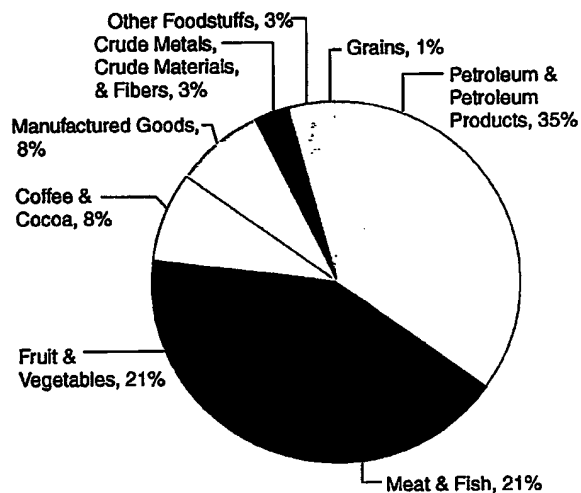
Ecuador's Total Imports by Commodity, 1995



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Ecuador's Total Exports by Commodity, 1995



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